



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Introduced:	02/18/11	Bill No:	Assembly Bill 1007
Tax Program:	Sales and Use Tax	Author:	Cook
Sponsor:	Author	Code Sections:	RTC 6397
Related Bills:		Effective Date:	Upon enactment, but operative 08/03/12

BILL SUMMARY

This bill would provide a sales tax exemption on the sale of “qualified back-to-school products,” including any article of clothing, footwear, school supplies, and sports equipment for \$100 or less, during a four-day period in August 2012.

ANALYSIS

CURRENT LAW

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in this state. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded.

Under current law, sales of clothing and footwear, as well as school supply items and sports equipment, are generally subject to the sales or use tax to the same extent as any other sale of tangible personal property not otherwise exempted or excluded by statute. However, Revenue and Taxation Code Section 6375.5 of the Sales and Use Tax Law provides an exemption for sales of new children’s clothing when sold to a nonprofit organization for its distribution without charge to elementary school children.

Beginning July 1, 2011, the statewide sales and use tax rate (7.25%) imposed on taxable sales and purchases of tangible personal property is made up of the following components (additional transactions and use taxes (also known as district taxes) are levied by various local jurisdictions and are not reflected in this chart):

Rate	Jurisdiction	Purpose/Authority
5.00%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
0.25%	State (Fiscal Recovery Fund)	Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5, operative 7/1/04)
0.50%	State (Local Revenue Fund)	Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)
0.50%	State (Local Public Safety Fund)	Local governments to fund public safety services (Section 35, Article XIII, State Constitution)

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Rate	Jurisdiction	Purpose/Authority
1.00%	Local (City/County) 0.75% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

The 1% General Fund tax under Sections 6051.7 and 6201.7 will expire on 6/30/11.

PROPOSED LAW

This bill would add Section 6397 to the Sales and Use Tax Law to provide a sales tax exemption for the sale of “qualified back-to-school products” on an annual basis during a four day period in August, beginning at 12:01 a.m. on the first Friday of August 2012, and ending at 12:00 midnight on the first Monday of August 2012 (August 3 through 6, 2012). This bill would provide that “qualified back-to-school products” include the following:

- Individual articles of clothing with a retail price not to exceed \$100.
- Footwear for a retail price not to exceed \$100.
- School supplies, including pens, paper, pencils, binders, notebooks, school textbooks, book bags, backpacks, lunch boxes, and calculators for a retail price not to exceed \$100.
- Sports equipment with a retail price not to exceed \$100.

This bill would require that the sale of qualified back-to-school products be made by the purchaser at the retailer’s physical place of business.

This is an urgency bill and would take effect immediately, but would not be operative until the first Friday in August 2012.

BACKGROUND

This proposed law is modeled after a similar law in New York State. Sales of clothing and footwear are exempt from tax in New Jersey, and many residents of New York went to New Jersey to purchase their clothes. To help discourage this, New York State implemented a law in 1997 allowing for a one-week exemption from the tax for the sales of clothing valued under \$100. The State of New York continues to offer the sales tax exemption on clothing items, but due to budget concerns in that state, the exemption for clothing items costing less than \$110 was suspended from October 2010 to April 2011. Starting in April 1, 2011 the exemption will be reinstated but only for items costing below \$55. Then, beginning after March 31, 2012, the exemption for items priced less than \$110 will be reinstated in full.

Currently, there are fifteen states that will have a sales tax holidays in effect in 2011 for the purchase of clothing, and/or school supplies, and/or computers during a specified period in August. These states include the following: Alabama, Connecticut, Iowa, Louisiana, Maryland, Mississippi, Missouri, New Mexico, New York, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, and Virginia.

Minnesota, New Jersey, Pennsylvania and Rhode Island offer a limited year-round sales tax exemption on clothing.

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California has had several “sales tax holiday” bills introduced over the years that would have provided a sales tax exemption for certain types of merchandise:

Clothing and Footwear. AB 1185 (Mountjoy, 2001) would have provided a partial sales tax exemption for clothing and footwear purchased for \$200 or less during a one-week period in August, starting in 2003, and continuing for the same one-week period for each year thereafter. AB 1185 was held under submission in Assembly Revenue and Taxation Committee.

AB 944 (Cardenas, 1999) would have provided a partial sales tax exemption for clothing and footwear purchased for \$100 or less during a 3-day period in August 2001. The bill was never heard in Senate Revenue and Taxation Committee.

Clothing, Footwear, and Computers. AB 548 (Garcia, 2005) would have provided a sales tax exemption for any article of clothing, clothing accessory, or footwear for \$100 or less, school supplies for \$500 or less, and personal computers and related accessories for \$1,000 or less, during a four day period in August 2006. The bill was held under submission in Assembly Revenue and Taxation Committee.

AB 1199 (Cardenas and Matthews, 2001) would have provided a sales tax exemption for clothing and footwear purchased for \$200 or less and computers and computer-related equipment purchased for \$1,000 or less during a 3-day period in August 2001. AB 1199 was held under submission in Assembly Appropriations Committee.

Computers. AB 2056 (Zettel, 2002) would have provided a partial sales and use tax exemption for qualified personal computer products during a 2-day period in August, starting in 2002, and continuing for the same 2-day period for each year thereafter. The bill was held under submission in Assembly Revenue and Taxation Committee.

AB 1977 (Strickland, 2002) would have provided a partial sales tax exemption for specified computer products purchased for \$2,000 or less during a 3-day period at the end of August or the beginning of September, starting in 2003, and continuing for the same 3-day period for each year thereafter. AB 1977 was held under submission in Assembly Revenue and Taxation Committee.

All tangible personal property. AB 1320 (Ashburn, 1999) would have provided a sales tax exemption for tangible personal property purchased for \$500 or less during the week of January 17 to January 23. This bill would have sunset on January 1, 2005. AB 1320 failed to pass from its house of origin by the deadline.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author is intended to provide a sales tax holiday that will help preserve California's high educational standards by helping parents buy the supplies their children need for academic success.
2. **Definition of clothing and footwear.** The proposed law does not define what is meant by clothing and footwear. Would the proposed exemption apply to the sale of any article of clothing and footwear designed to be worn on or about the human body? Would the proposed exemption apply to the sale of accessories, including jewelry, handbags, luggage, umbrellas, wallets, watches, and similar items carried on or about the human body?

3. **Definition of sports equipment.** Without a definition of sports equipment the exemption would seem to apply to all types of sports equipment that most students would probably not be involved in and most schools probably don't offer as an extracurricular activity, for example, lawn bowling, paintball accessories, boxing, fly fishing, table tennis, snorkeling, hunting, hiking, kayaking, cricket, snowboarding, and surfing, just to name a few. The author may wish to specify certain sports associated with the sales tax exemption in order to provide a more focused benefit to student athletes.
4. **Exemption may not apply to some merchandise exchanges and rain checks.** Under current law, when merchandise is returned for other merchandise, the law considers the transaction as two separate transactions: a rescission of the original sale and a separate sale of the replacement merchandise. As an example, if a customer purchases a medium-sized shirt and exchanges the shirt for a small-sized shirt, the transaction is regarded under the law as a separate sale of the small-sized shirt and a rescission of the original sale of the medium-sized shirt. The retailer is allowed to deduct from his or her taxable sales amount for purposes of reporting the correct amount of sales tax to the BOE, the sales price of the medium-sized shirt, and is also required to include in his or her taxable sales amount, the sales price of the small-sized shirt. Using this example under the proposed holiday period, if the medium-sized shirt is purchased during the sales tax holiday period, and is exchanged for the small-sized shirt *after* the holiday period, the proposed exemption would not apply to the exchange of the small-sized shirt since that transaction is recognized under the law as having occurred after the exempt holiday period. This may result in reporting errors by retailers and added confusion and inquiries by customers.

Another source of confusion could result from the use of rain checks. Current law also provides that a rain check issued by a retailer does not constitute a sale of tangible personal property. Therefore, if a retailer is out of stock of a particular item and issues a rain check to the customer during the holiday period, and the customer subsequently uses the rain check to purchase the out of stock item after the proposed holiday period, the exemption would not apply.
5. **The sales tax holiday could increase retailer's costs.** Creating a sales tax exemption that only lasts for four days would place an additional burden on retailers to have their cash registers programmed to tax sales on certain dates and not tax sales on other dates. This may require retailers to incur costly and frequent reprogramming of their registers to accommodate the change. Retailers would presumably be compensated for this by increased sales activity during the specified period.
6. **Exemption applies to sales tax only.** The proposed law would exempt sales of any article of clothing, footwear, school supplies, and sports equipment from the computation of the sales tax, but not the use tax. Therefore, California consumers ordering these items from out-of-state, Internet and mail order retailers, for example, would continue to remain liable for the use tax during the specified period.
7. **Technical suggestion.** The author intends to provide California consumers a sales tax exemption on the sale of "qualified back-to-school products," including any article of clothing, footwear, school supplies, and sports equipment for \$100 or less, on the first Friday of August and ending on the first Monday in August. If this bill were

effective this year, the first Friday in August would be August 5th, while the first Monday in August would be August 1st. The first Monday immediately following the first Friday in August 2011 would be August 8th. BOE staff is willing to work with the author's office in drafting amendments to the bill that would address this issue.

COST ESTIMATE

Administrative costs would be incurred in preparing and mailing a special notice to affected retailers, creating and distributing new sales tax charts to affected retailers, and answering potentially numerous inquiries. An estimate of these costs is pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Clothing and Footwear. As reported by the Department of Commerce, national personal consumption expenditures for clothing and footwear amounted to \$322.2 billion in 2009. We assume that California accounts for 12% of national sales, as California's population is 12% of the total United States population. Sales of clothing and footwear in California were estimated to be \$38.7 billion in 2009.

If we include the recession period in 2009, taxable sales remained relatively flat at an average of 1.4% through 2012. We assume that sales of clothing and footwear will increase by the same 1.4% annually, therefore, the estimated sales of clothing and footwear in California for 2012 will be \$40.4 billion. If we assume that 75% of clothing and footwear are priced at not more than \$100, then sales for 2012 is estimated to be \$30.3 billion.

We would expect sales of clothing, footwear and school supplies to be higher than average for the periods when these sales would be exempt from the sales tax. The state of Texas found that during a week's tax holiday on clothing and footwear, sales were double the normal weekly sales. Based on this information, we assume that the four-day period involved represents 8/365 (8 days) of a year's worth of sales. Estimated sales for the four-day exemption period in August of 2012 are \$664 million.

School Supplies. School supplies are defined to include, but not be limited to, pens, paper, pencils, binders, notebooks, school text books, book bags, backpacks, lunch boxes and calculators.

School supplies are purchased in a variety of different types of retail establishments. The most likely places to purchase these types of items are book and stationery stores, office supply stores, and supermarkets. Based on information from the merchandise line sales compiled by the U.S. Department of Commerce, we estimate that school supplies represent about 6.3% of the total sales made at these stores. By applying this percentage to 2009 taxable sales for those types of stores, we estimate that purchases of school supplies amounted to \$1.633 billion in 2009. Assuming a 1.4% annual growth, the sales of school supplies in 2012 is estimated to be \$1.701 billion.

While the purchase of school supplies is spread throughout the year, more of these purchases would be made just prior to the start of a new school year. We estimate that as much as 20 percent of the total year's purchases could be made during the four-day exemption period. Estimated sales of school supplies for the four-day exemption period in August of 2012 are \$340 million.

Sports Equipment. As reported by the Department of Commerce, national personal consumption expenditures for sports equipment amounted to \$60.7 billion in 2009. We assume that California accounts for 12% of national sales, as California's population is 12% of the total United States population. Sales of sports equipment in California were estimated to be \$7.3 billion in 2009.

If we include the recession period in 2009, taxable sales remained relatively flat at an average of 1.4% through 2012. We assume that sales of sports equipment will increase by same 1.4% annually, and then the estimated sales of clothing and footwear in California for 2012 will be \$7.6 billion. If we assume that 75% of sports equipment are priced at not more than \$100, then sales for 2012 is estimated to be \$5.7 billion.

We would expect sales sports equipment supplies to be higher than average for the periods when these sales would be exempt from the sales tax. Purchases of sports equipment are normally higher during the summer months. This proposal does not limit sports equipment to the major sports of baseball, basketball, and football, therefore we assume it also includes the purchase of guns and ammunition, fishing and camping supplies, and any other equipment related to a sport. We estimate that as much as 5% of the total year's purchases of sports equipment could be made during the four-day exemption period. Estimated sales of school supplies for the four-day exemption period in August of 2012 are \$285 million.

REVENUE SUMMARY

The revenue loss from exempting from the sales tax on clothing, footwear, school supplies, and sports equipment purchased during four day period in August of 2012 would be as follows:

<u>Revenue Impact</u> (In millions)	
State (5.0%)	\$ 64.4
Fiscal Recovery (0.25%)	3.2
Local Revenue (0.5%)	6.4
Public Safety Fund (0.5%)	6.4
Cities and Counties (1.0%)	12.9
Special District (0.86%)	11.1
Total Revenue Loss	<u>\$ 104.4</u>

Qualifying Remarks. Under this bill, local jurisdictions are given the option to have the exemption not apply to their local or transit taxes. This estimate gives the loss if the exemption applies to all local taxes.

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